How Dell Computer outflanks the big boys

Mutual funds that try too hard

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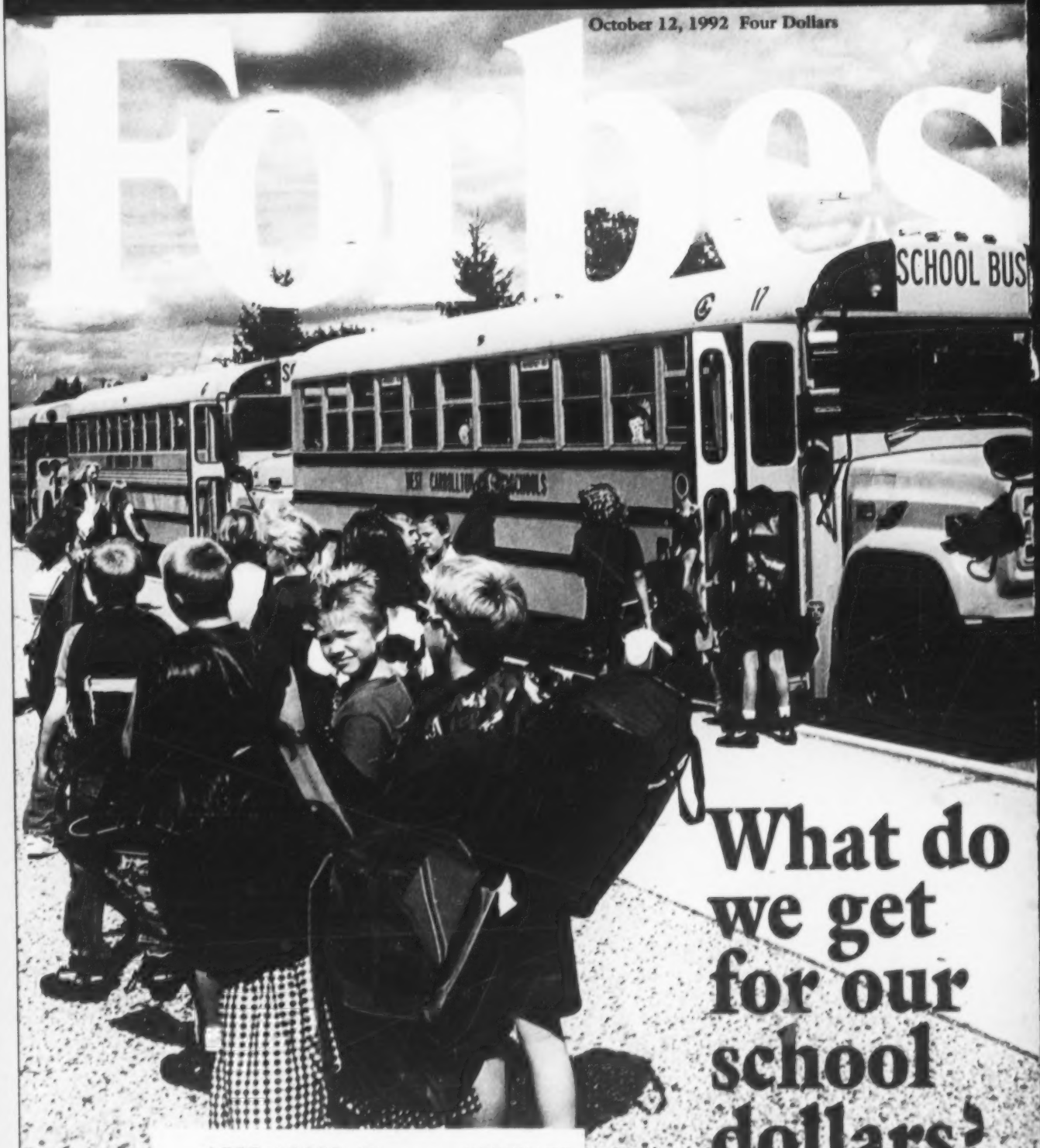
October 12, 1992 Four Dollars

Forbes



What do we get for our school dollars?

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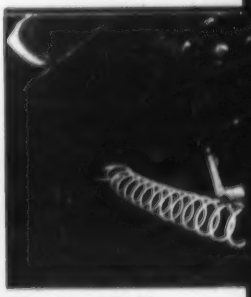

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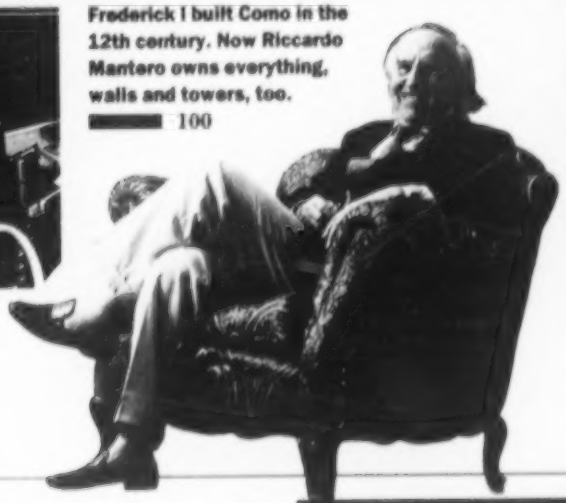

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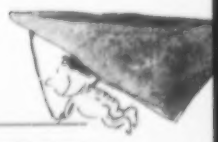

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Cover photo by David Carter

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THE FORBES INDEX

BY ROBERT ROSENSTEIN

Judged by most components of the Forbes Index, the economy appears to be dead in the water. But economist David Cohen at MMS International argues that "self-correcting mechanisms" will eventually pave the way for a healthy recovery. Low mortgage rates and productivity gains from corporate cost-cutting are already starting to stimulate higher spending on capital goods and residential construction, Cohen says. For example, unadjusted housing starts for August reached 111,000, putting this volatile indicator 17% higher than its August 1991 level.

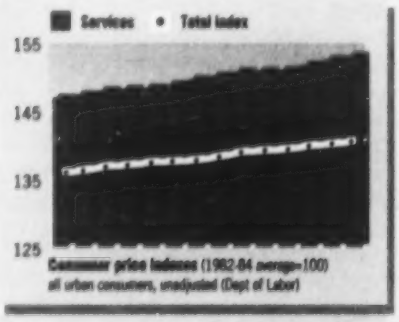
Other key ratios	Source	Status
Prime rate	Chase Manhattan Bank	6.0%
Auto sales year to date vs 1991[1]	Ward's Automotive	1.4%
Index of leading indicators July vs June	Dept of Commerce	0.1%
Trade balance 12 months ended July1992	Dept of Commerce	-$72bil
All-commodity producer price index Aug vs July[2]	Dept of Labor	-0.2%
GDP 2nd quarter vs 1st—annualized growth	Dept of Commerce	1.4%
M2 (3-month change)—annualized growth[3]	Federal Reserve	-0.8%

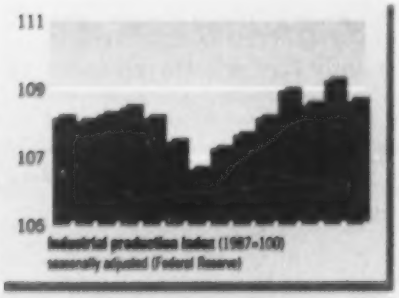
[1] U.S.-based manufacturers, excludes imports, as of 9/10/92. [2] Wholesale goods. [3] Includes M1 (public currency and checking deposits) plus savings accounts and money market funds.

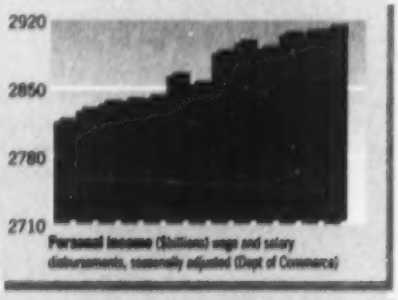
Index components

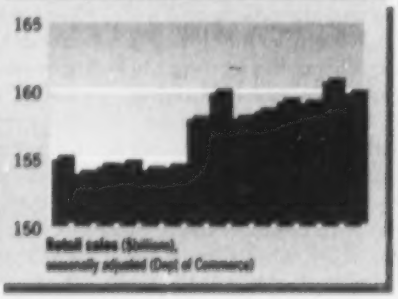
The Forbes Index is a measure of U.S. economic activity composed of 8 equally weighted elements: The cost of services relative to all consumer prices, the level of new orders for durable goods compared with manufacturers' inventories, total industrial production, new housing starts, personal income, new claims for unemployment compensation, total retail sales, total consumer installment credit.

To measure these 8 elements, FORBES monitors 10 series of U.S. government data. The last 14 months' data for each series are presented below.









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THE FORBES/BARRA WALL STREET REVIEW

BY ERIC S. HARDY

Is the ten-year bull market over? The Barra All-US price index is up only 0.3% since the start of the year. Dan Ascani, whose *Global Market Strategist* newsletter evaluates the U.S. and foreign markets, is expecting a short-term decline in the U.S. market. Ascani cites two technical factors—low advance/decline ratios and a lack of momentum—as part of the reason for his bearishness. Another part: fundamentals. Today's buyers of U.S. stocks are being asked to pay 27 times trailing earnings and to accept a yield of less than 3%. Ascani thinks that in the next few months the Dow could decline to the 2800-to-3100 level.

On the other hand, Ascani sees a bit of hope that if the market does fall, it will pick up again later in the year. Falling interest rates will help. And Ascani believes the recent uncertainty in European financial markets could pull foreign investors into American stocks after the November election.

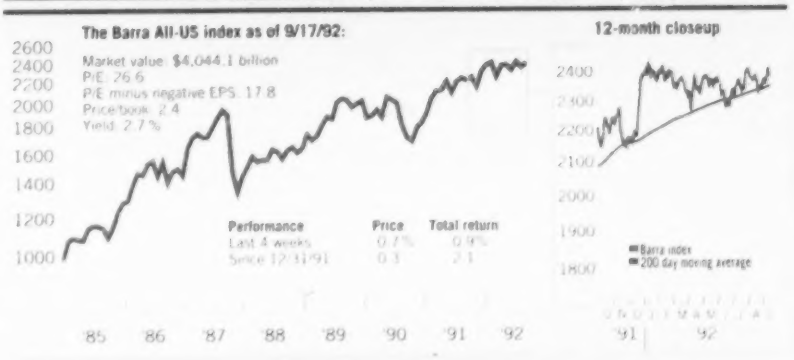
Special focus

Some stocks have posted nice gains even though their industry groups were out of favor. Example: While the coal and uranium industry has had a negative return of 39% since the start of the year, Addington Resources is up 31%. The stocks below, listed with the worst industries first, all overcame the handicaps afflicting their industries.

Going against the tide

Company/Industry	Return
Addington Res/coal, uranium	31%
Vornado/real estate	28
Ailwaste/pollution	12
Triton Energy/foreign petrol	8
Life Technologies/drugs	22
Kerr McGee/oil refining	20
Gendex/health svcs	56
Newmont Mng/precious metals	21
X-Rite/photography	66
Alcoa/aluminum	2

The overall market



Closeup on the market

Index or investment	2-week change	% change from 1 year	% change from 5-year high
Barra All-US index	0.5%	8.4%	-2.3%
S&P/Barra Growth index	1.3	12.3	1.3
S&P/Barra Value index	0.2	10.6	-2.7
Dow Jones industrials	0.7	9.6	-2.9
S&P 500	0.5	8.4	-1.3
NYSE	0.4	8.6	-1.2
Nasdaq	2.3	12.5	-8.9
Amex	0.0	4.5	-8.1
EAFE	-5.6	7.7	-27.1
CRB index[1]	0.3	6.8	-25.8
Gold	2.1	0.1	-30.7
Yen	0.4	7.3	-24.1
Oil[1]	2.8	2.5	-45.8

The best and worst performing stocks[2]

Best	Price	2-week change	1992 EPS[3]	Worst	Price	2-week change	1992 EPS[3]
Valence Technology	15	52%	$ 0.41	Stac Electronics	3⅛	-52%	$-0.36
Constar International	32¼	43	1.52	Lunar	2¼	-39	1.04[4]
Dominion Bankshares	16⅛	38	0.65	Hartmarx	3⅛	-39	-0.51
Vestar	12½	35	0.25	Video Lottery Technologies	21½	-38	1.06
Network General	12⅜	33	0.59	Alliance Pharmaceutical	10⅛	-35	1.04

The best and worst performing industry factors[5,6]

Best	2-week change	Since 12/31/91	Worst	2-week change	Since 12/31/91
Consumer durables	4.7%	11.6%	Coal & uranium	-6.7%	-28.0%
Industrial equipment	4.4	3.6	Drugs	-3.1	16.0
Pollution control[7]	4.0	-13.0	Thrifts	-2.8	-9.9
Electronics	3.8	11.4	Health care	-2.2	14.5
Construction	3.4	10.9	Gas utilities	1.4	8.5

Note: Data for period ending 9/17/92. The Barra All-US index consists of all publicly traded common stocks for which price quotations are available and ordinary shares of foreign stocks trading on U.S. markets. ADRs, REITs and closed-end funds are excluded. [1] Total return of a portfolio of more than 150 large-capitalization stocks that has high historical earnings growth and has predicted above average earnings growth. [2] Total return of more than 300 large capitalization stocks characterized by low price-to-book ratios, high yields and low price to earnings ratios. [3] A dollar denominated capitalization weighted index of more than 1,000 stocks from Europe, Australia, New Zealand and the Far East. Source: Morgan Stanley Capital International Perspective. [4] Index of 21 commodity futures. [5] Knight-Ridder Financial Information. [6] During the last two weeks. [7] Estimate. Source: Institutional Brokers Estimate System, from IBES, Inc. [8] Shows return to the industry factor after controlling for other influences, including company size, value and growth characteristics. Multi-industry firms have proportional contributions in two or more groups. [9] 1993 estimate. Principal source: Barra, Inc., Berkeley, Calif.

WORLD MARKETS REVIEW

BY GUSTAVO LOMBO

Foreign vs. U.S. markets

Developed markets

Market	Total return[2] 3 months	12 months	P/E
Switzerland	7%	26%	14
Japan	6	-9	38
Netherlands	4	24	13
Belgium	1	21	13
Canada	0	-6	60
Finland	-25	-34	NM
Norway	-21	-24	NM
Spain	-16	-8	8
Australia	-13	-7	24
Denmark	-12	-10	NM

Emerging markets[3]

	Total return[2] 3 months	12 months	P/E
Region			
Asia	-8%	-18%	NA
Latin America	-16	27	NA
Country			
Colombia	41	295	39
Philippines	25	58	20
Jordan	15	48	15
India	-30	48	35
Brazil	-29	6	6
Argentina	-27	151	20

Politics, interest rates and currency crises have made for a volatile summer on Europe's stock exchanges. The razor-thin French approval of the Maastricht treaty on Sept. 20 was an encouraging sign for those who think economic conglomeration will improve the European economies. But the battle over the treaty is far from over; expect the currency markets to remain chaotic.

The Tokyo market posted a total return (including meager dividends) of 6% for the three months through Aug. 31. But this is mainly just a correction. "A lot of damage was done to this economy by the deflation of the asset bubble," says Steven Resnick, an analyst at Cowen & Co. in Boston. Resnick predicts that even if the Japanese economy responds to government fiscal stimulus, it will take years for stocks to return to their former levels.

In spite of Argentina's poor performance over the last three months, Gerald Rothstein, director of international research at Oppenheimer & Co., remains bullish on Argentina's economy. He expects its stock market to rebound sharply over the next 12 months.

Who's hot

Company/Country	Business	Price	3-month price change	P/E
SMH/Switzerland	consumer goods	1,004¾	40%	17
Long-Term Credit Bank/Japan	banking	8½	38	39
Pegasus Gold/Canada	gold mines	17⅛	37	38
Yasuda Fire & Marine/Japan	insurance	6⅛	33	50
Air New Zealand/N Zealand	airline	1⅛	24	23

Who's not

Company/Country	Business	Price	3-month price change	P/E
Vallehermoso/Spain	real estate	9⅜	-58%	4
Skand Enskilda Bank/Sweden	banking	3¼	-54	2
Dragados y Construcciones/Spain	construction	10⅝	-48	8
Fisons/UK	pharmaceuticals	3⅜	-48	8
Fletcher Challenge/N Zealand	forest products	1¼	-36	12

Cheap foreign stocks

Company/Country	Business	Price	Earnings	P/E
Daiwa House/Japan	construction	13¾	$0.69	20
BTR/UK	multicompany	8	0.63	13
Alcatel Alsthom/France	electronics	127¼	10.68	12
VNU/Netherlands	broadcast, pub	48⅞	5.79	8
Thomson-CSF/France	aerospace	26½	4.40	6

High-yielding foreign stocks

Company/Country	Business	Price	Yield	P/E
Sime Darby/Hong Kong	trading	1¼	8.5%	12
Electrabel/Belgium	utility	157¼	8.5	10
Westfield Trust/Australia	real estate	1¾	8.1	13
Interprovincial Pipeline/Canada	oil pipeline	21¼	7.9	12
Transalta Utilities/Canada	utility	12	6.9	12

Note: Data for period ending 8/31/92. Selected stocks have a market capitalization of at least $300 million. [1]Shows price return on the EAFE index of European, Australian, New Zealand and Far Eastern stocks converted into U.S. dollars. [2]Performance numbers reflect both local price change and currency fluctuation. Dividends are reinvested after subtracting foreign withholding tax. [3]For period ending 7/31/92. NA: Not available. NM: Not meaningful. Principal source: Morgan Stanley Capital International Perspective. Emerging markets data provided by International Finance Corporation.

The returns of aggressive growth funds have been peculiarly passive.

Slow grow

By Mary Beth Grover

AGGRESSIVE GROWTH FUNDS, financial planners say, can really give a jolt to your portfolio. Take more risk, get more reward. Like a snorting bronco, an aggressive growth fund may leave you bruised and breathless now and then—but it will also carry you ahead far faster than an old nag like a growth and income fund.

That's the sales pitch. But is it true? Not necessarily.

Alas, most aggressive growth funds deliver the extra risk but seldom come through with more reward. Over the ten years ended in August, a group of 22 aggressive growth funds averaged returns of just over 11%, well behind the 14% return of 77 growth and income funds. Our authority here is the Chicago-based fund rater Morningstar, Inc., which also reports that over the same period, the aggressive funds lagged the S&P 500 by more than six points per year. Just 2 aggressive funds—AIM Constellation and Putnam Voyager A—beat the S&P.

What's going on here? How come the nags are beating the broncos? How come taking more risk doesn't produce more reward?

One simple answer: too much turnover. Stewart Zobian, portfolio manager at one of the jumpiest aggressive growth funds around, Value Line Leveraged Growth Investors, trades stocks like a man whose pants are on fire: Last year Value Line Leveraged Growth's turnover was 250%. Flinging stocks around like hot potatoes has not helped the fund's performance in the long run; in some years, the faster it runs, the behinder it gets. From 1981 through 1991 turnover ranged between 89% and 250%, yet the fund returned just 15.2% for the period, versus 17.5% for the S&P 500.

All told, the turnover rate at aggressive growth funds averages a hyperkinetic 153%—twice the rate at growth and income funds. That churns up brokerage and administrative fees. The average aggressive growth fund runs a 1.94% expense ratio, versus just 1.48% for equity funds overall.

The nags did get a bit of adrenaline from declining interest rates: Growth and income funds hold more fixed-income securities than do aggressive funds, and the period has been kind to bonds. At the same time, the boom in index funds has boosted the big-capitalization stocks, and these, too, tend to make up bigger parts of the portfolios of the growth and income funds than of the aggressive growth funds.

Is the pendulum about to swing back toward the aggressive growth funds? Some people think so. Indexing may already have done all the damage it can, and interest rates could easily turn up again. But don't be too quick to accept this scenario.

Consider this: After studying the returns on more than 9,500 stocks from 1963 to 1990, University of Chicago business school professors Eugene Fama and Kenneth French concluded that a stock's risk, measured by "beta," or its fluctuation relative to the market as a whole, is not a reliable predictor of performance. While stocks with high betas should, in theory, race ahead, Fama and French found that stocks with low betas performed roughly as well. In short, investors get little recompense for taking higher risk.

Uh oh. Aggressive growth funds average a beta of 1.23, meaning they are 23% more volatile than the overall market. That higher risk does not ensure a better return. Says French: "What investors really get paid for is holding dogs"—stocks trading roughly at or at less than their book value. Small-cap dogs, say Fama and French, outperformed the market by 6% annually over the time period.

That's ominous for aggressive growth fund holders, since the average stock in their portfolios is trading at four times book value—roughly one-third higher than the S&P 500.

So investors who want to bet on small-cap stocks should pick value-oriented funds, not their aggressive growth counterparts, over the next few years, says Kurt Brouwer of Brouwer & Janachowski, a San Francisco-based investment advisory firm. "The market at these valuations is not cheap," says Brouwer. "It would be sad to see conservative investors with good returns switch to aggressive growth funds at this point."

After all, old Aesop had it right: Bet on the tortoise, not on the hare. ■

Gung ho . . . or look out below

Fund	10-year return[1]	Turnover[2]	Price/book[3]	Beta[3]
Dreyfus Capital Growth	15.5%	81%	4.0	0.90
Financial Dynamics	12.5	174	5.8	1.27
44 Wall Street	-11.1	98	3.6	0.78
Keystone Custodian S-4	12.8	73	4.6	1.56
Putnam Voyager A	18.4	49	5.5	1.29
Security Ultra	8.9	163	3.7	1.53
Seligman Capital	17.3	42	5.9	1.30
SteinRoe Capital Opportunities	11.0	69	6.7	1.38
Value Line Leveraged Growth	12.2	250	6.2	1.18
Value Line Special Situations	5.8	37	3.1	1.11
S&P 500	17.5			

[1]Annualized through Aug. 31. [2]Latest available figures. [3]Through Aug. 31. *Source: Morningstar, Inc.*

These were the largest aggressive growth funds ten years ago. At four of them, assets have shrunk instead of growing, and only one has beaten the S&P 500.